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ECJ CLARIFIES SCOPE OF EU BLOCKING REGULATION AND REQUIREMENT NOT TO COMPLY WITH US SECONDARY SANCTIONS

In a significant judgment, the European Court of Justice has confirmed that Article 5 of the EU Blocking Regulation may found a civil claim from parties affected by such compliance. Where there is a prima facie case that a party has acted in order to comply with US extra-territorial sanctions, the onus will shift to the party seeking to defend such a claim to show that they did not act to comply with such sanctions. This makes walking the tightrope between the EU Blocking Regulation and US secondary sanctions all the more difficult.

The EU Blocking Regulation

The EU Blocking Regulation¹ aims to counteract and protect EU persons from the effect of specified US extra-territorial sanctions,² which the EU considers to be contrary to international law and to impede the EU's single market.³

The UK retained the EU Blocking Regulation as UK law following the end of the Brexit transition period.⁴⁵

Article 5 of the EU Blocking Regulation prohibits compliance with extraterritorial sanctions by EU persons unless authorised by the EU Commission under paragraph 2 of Article 5.

Commercial consequences

Article 5 puts commercial entities in an invidious position. Breaching US extraterritorial sanctions may result in significant fines, designation on a sanctions list, exclusion from the US financial system or even imprisonment. However, non-compliance with the EU Blocking Regulation may give rise to contractual claims (and financial compensation), fines or criminal prosecution.

Particular difficulties arise where an EU entity's counterparty is added to the US sanctions list. The EU entity may either continue the commercial relationship and potentially face US regulatory enforcement, or terminate the relationship and face a civil claim and/or enforcement from EU regulators.

Bank Melli v Telekom Deutschland

In *Bank Melli v Telekom Deutschland*,⁶ Telekom Deutschland provided telecommunication services to the German branch of Bank Melli, an Iranian bank. In November 2018, the US reimposed extraterritorial sanctions on Bank Melli.⁷ Two weeks later Telekom Deutschland terminated its contract with Bank Melli.

¹ Council Regulation (EC) No 2271/96 (as amended)

² Sanctions which apply to persons outside of the direct jurisdiction of the sanctions authority imposing the measures, for example US sanctions that restrict the actions of EU persons.

³ Recitals 3 and 5 of Council Regulation (EC) No 2271/96 (as amended)

⁴ Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom (Retained EU Legislation)

⁵ Protecting against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations 2020/1660

⁶ Case C-124/20 Bank Melli Iran, Aktiengesellschaft nach iranischem Recht v Telekom Deutschland GmbH

⁷ Executive Order 13846 of August 6, 2018

Bank Melli brought a claim in the German courts, arguing that Telekom Deutschland had terminated the contract to comply with the US extraterritorial sanctions in contravention of the EU Blocking Regulation.⁸ The German court referred several questions on the interpretation of the EU Blocking Regulation to the ECJ.

Opinion of Advocate General Hogan

Until recently, it had been thought, based on EU Commission Guidance, that EU entities which relied on pure commercial reasons for not continuing to do business with entities which were subject to relevant US extraterritorial sanctions would not infringe Article 5 of the EU Blocking Regulation.⁹

However, in May 2021 Advocate General Hogan issued an opinion in the *Melli* case that called this approach into question.¹⁰

Decision of the ECJ

On 21 December 2021 the ECJ gave judgment in the referral from the German courts clarifying the position.¹¹ Specifically, the ECJ held:

- No judgment or direction from US authorities is required for Article 5 of the EU Blocking Regulation to be engaged;¹²
- Article 5 may found a civil claim from a party whose contract has been terminated in apparent compliance with relevant US extra-territorial sanctions;¹³
- While an EU entity is not required by the EU Blocking Regulation to give reasons for terminating a contract, if there is a prima facie case that the contract has been terminated in order to comply with relevant extra-territorial sanctions then the burden of proof will rest with the party claiming that there were other reasons for termination;¹⁴
- National courts will need to consider the proportionality of any remedy, such as a decision to annul the termination of the contract. A relevant factor will be the economic losses to be suffered by the terminating party, for example if it loses access to the US financial system. However, another factor to be considered is whether the terminating party applied for authorisation from the European Commission to comply with US sanctions when it could have done so.

The ECJ's decision leaves EU operators with slightly more room for manoeuvre insofar as the burden of proof under Article 5 has only been reversed in instances where there is a prima facie case that an EU entity has complied with US extraterritorial sanctions. In the *Melli* case, there was a prima facie case due to the timing of the termination, Bank Melli had always paid on time, and several other Iranian customers on the SDN list had their contracts terminated at the same time.

However, EU entities that seek to terminate relationships should ensure that they are able to demonstrate that any decision to terminate that contractual relationship was made for reasons other than to comply with US sanctions. Serious consideration should be made as to whether to apply for permission to comply with the extra-territorial sanctions.

Impact of the decision

The EU Blocking Regulation was recently subject to a consultation on its reform,¹⁵ and may be amended as early as the second quarter of 2022. It is possible that such amendments will reflect the ECJ's decision in the *Melli* case.

From a UK perspective, ECJ case law post-dating the end of the Brexit transition period is not binding but may be referred to, to the extent it is relevant. Further, principles and rights set out in the EU Charter of Fundamental Rights may be referred to as if they were corresponding retained rights in UK law.¹⁶ While the UK courts will not be bound to follow the *Melli* decision, it may still inform interpretation of the EU Blocking Regulation as retained in the UK.

⁹ Guidance Note — Questions and Answers: adoption of update of the Blocking Statute C/2018/5344

¹⁰ Advocate General's Opinion in Case C-124/20 Bank Melli Iran, Aktiengesellschaft nach iranischem Recht v Telekom Deutschland GmbH

¹¹ Judgment of 21 December 2021, *Bank Melli v Telekom Deutschland GmbH*, C-124/20, EU:C:2021:1035

¹² [5] *Ibid.*

¹³ [59] *Ibid.*

¹⁴ [67] *Ibid.*

¹⁵ Inception impact assessment - Ares(2021)4911405

¹⁶ *Lipton & Anr. v BA City Flyer Limited* [2021] EWCA Civ 454

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